

EXPOSURE DRAFT: HEDGE ACCOUNTING FOR A PORTFOLIO HEDGE OF INTEREST RATE RISK

On 21 August 2003, the IASB published an exposure draft, Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk, proposing a “macro hedging” amendment to IAS 39. This amendment was not among the changes to IAS 39 that the Board had proposed in July 2002. The Board has determined that this change is of a magnitude that warrants the solicitation of public comment. Comment deadline is 14 November 2003. The Board will issue an amended IAS 39 without the macro hedging proposal by the end of 2003. Another version reflecting the final macro hedging decision is planned for March 2004.

The ED’s approach to “macro hedging”. The ED would permit an entity to use fair value hedge accounting for a portfolio hedge of interest rate risk. This is sometimes called “macro hedging”. Pursuant to the approach in the ED:

1. The entity identifies a portfolio of items whose interest rate risk it wishes to hedge. The portfolio may include both assets and liabilities.
2. The entity analyses the portfolio into time periods based on expected, rather than contractual, repricing dates.
3. The entity designates the hedged item as a percentage of the amount of assets (or liabilities) in each time period from step 2. All of the assets from which the hedged amount is drawn must be items (a) whose fair value changes in response to the risk being hedged and (b) that could have qualified for fair value hedge accounting under IAS 39 had they been hedged individually. The time periods must be sufficiently narrow to ensure that all assets (or liabilities) in a time period are homogeneous with respect to the hedged risk – that is, the fair value of each item moves proportionately to, and in the same direction as, changes in the hedged interest rate risk.
4. The entity designates what interest rate risk it is hedging. This risk could be a portion of the interest rate risk in each of the items in the portfolio, such as a benchmark interest rate like LIBOR.
5. The entity designates a hedging instrument for each time period. The hedging instrument may be a portfolio of derivatives (for instance, interest rate swaps) containing offsetting risk positions.
6. The entity measures the change in the fair value of the hedged item (from step 3) that is attributable to the hedged risk (from step 4). The result is recognised in profit or loss and in one of two separate line items in the balance sheet. The balance sheet line item depends on whether the hedged item is an asset (in which case the change in fair value is reported in a separate line item within assets) or is a liability (in which case the value change is reported in a separate line item within liabilities). This separate balance sheet line item is presented on the face of the balance sheet adjacent to the related asset(s) or liability(ies) – but it cannot be allocated to individual assets or liabilities, or to separate classes of assets or liabilities (that is, no “basis adjustment”).
7. The entity measures the change in the fair value of the hedging instrument and recognises this as a gain or loss in profit or loss. It recognises the fair value of the hedging instrument as an asset or liability in the balance sheet.
8. Ineffectiveness is the difference in profit or loss between the amounts determined in step 6 and step 7.

A change (up or down) in the amounts that are expected to be repaid or mature in a time period will result in ineffectiveness. That ineffectiveness is the difference between (a) the initial hedge ratio applied to the initially estimated amount in a time period and (b) that same ratio applied to the revised estimate of the amount.

Demand deposits and similar items with a demand feature (such as a bank’s ‘core deposits’) cannot be designated as the hedged item in a fair value hedge for any period beyond the shortest period in which the counterparty can demand repayment. Thus deposits payable immediately on demand are not eligible for hedge accounting.

Effective date. Proposed to be 1 January 2005, same as the other changes to IAS 39.

Transition. The approach in the ED would be applied prospectively.

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